STATE OF WASHINGTON

DEPARTMENT OF LABOR AND INDUSTRIES

INDUSTRIAL INSURANCE FUND

FINANCIAL INFORMATION
(UNAUDITED)

For the following funds:
608 - Accident Fund
609 - Medical Aid Fund
610 - Accident Reserve Fund

As of June 30, 2003

Prepared by: Insurance Services Division

11/07/03

State of Washington
Department of Labor and Industries
Industrial Insurance Fund

Management's Discussion and
Analysis of Results of Operations
and Financial Condition

Cash Flow from Operations

The Industrial Insurance Fund (the Fund) administers the Workers' Compensation Insurance program in the state of Washington. Workers' Compensation benefits are paid for wages lost during disability, permanent partial and total disability, vocational rehabilitation and medical costs incurred in conjunction with the injury. Benefits are funded by premiums paid by employers and employees who are not self-insured and earnings of the Fund's investment portfolio.

Premiums collected during the twelve months ending June 30, 2003 were $898 million, increasing $58 million (6.9%) compared to the previous twelve months. The rate change provided the greatest part of the increase but slightly growing exposures provided some contribution.

Benefits paid during Fiscal Year 2003 were $1.11 billion, growing at 8.6% annually. The annual ratio of expenses paid to benefits paid was 16.9% as expenses paid declined 0.1% over the previous year.

Cash flow from investment income was reclassified in the prior quarter; income from bonds (primarily interest) was separated from equity dividends. Bond income was $113 million for the quarter and $472 million for the latest twelve months. The net cash income from equities was $21.9 million for the fiscal year.

Financial Condition

The contingency reserve is distributed by fund as follows:

	Contingency Reserve		
Funds	Upper Limit % of Liabilities	Current	Upper Limit Target
608	10%	$133 M	$337 M
610	1%	$0 M	$19 M
Accident*	6.7%	$133 M	$356 M
Medical Aid	15%	$324 M	$436 M
TOTAL	10%	$457 M	$792 M

The value of equity holdings increased by $191 million in the quarter, ending the fiscal year within $800 thousand of where it started. Total assets increased by $280 million in the quarter and $181 million in the fiscal year to end at $8.6 billion. The contingency reserve increased by $370 million in the quarter but declined $125 million for the fiscal year to end at $457 million. Equity results contributed $191 million to the contingency reserve and a law change regarding eligibility for hearing loss PPD benefits contributed another $200 million.

Annual net standard earned premiums increased 21.9% as the 1/1/03 rate increase began to take effect. Exposures increased modestly. Net annual retrospective return premiums were $101 million for the fiscal year.

Liabilities

Total benefit liabilities decreased by $37 million in the quarter but increased by $332 million in the fiscal year. A law change limiting eligibility for PPD benefits for hearing loss injuries provided a reduction of $200 million to the liabilities. The Accident Fund benefit liability decreased by $192 million in the quarter and increased by $20 million in the fiscal year. Medical Aid Fund benefit liabilities increased by $97 million in the fiscal year. The Pension Fund benefit liabilities increased by $88 million in the quarter and $216 million, or 12.8% in the fiscal year.

Accident Fund benefit liability estimates tested adequate by $184 million in the quarter, distorted by $200 million released as a result of the law change. Timeloss was adequate by $20 million but TPD tested adverse by $40 million.

The Medical Aid Fund tested inadequate by $14 million during the quarter, with $4 million of adequacy recognized in the Vocational Rehab liabilities.

The Claim Administration Expense liability estimates decreased by $17.9 million this quarter and $33.5 million in the fiscal year.

Reinsurance

The Fund does not currently carry reinsurance protection against catastrophic loss. Rates were deemed to be grossly excessive compared to the coverage provided.

Liquidity and Capital Resources

The Fund's operation requires liquidity sufficient to meet both short-term and long-term requirements. Short-term liquidity requirements come from three basic elements. First, workers' compensation claims are subject to some variation, usually inflationary. Second, benefit payment and investment operations are sensitive to variations in premium adequacy. Finally, dividends and retrospective premium adjustments require an increased degree of liquidity.

The Fund has generally met its operating requirements by maintaining appropriate levels of liquidity in its investment portfolio and through utilization of positive cash flow. This has allowed the Fund to minimize trading activity, maintain a stable investment portfolio, and provide a sound basis for adequate reserves for estimated future benefits.

The Washington State Investment Board and the Washington State Treasurer manage the Fund's investment portfolio. The portfolio is managed to balance cash flow, timing and reinvestment risks, and then maximize current income while preserving capital. The Fund has the financial capability to hold its fixed-income portfolio to maturity, and to match projected cash inflows from premiums and investment income from this portfolio with projected cash outflows for payment of benefits. All currently held fixed-income securities were rated Investment Grade when purchased. All foreign fixed-income securities are dollar-denominated. The values of invested assets and associated investment earnings are to be considered as preliminary values except for final statements at fiscal year ends.

All equity holdings are in the form of index funds. The Barclay-Wilshire 5000 equity fund (BGI) was designed to match the Wilshire 5000. The Wilshire 5000 index increased 16.0% in the quarter but is down 0.4% in the last twelve months. The EAFE index, tracking the performance of the International Index Fund, was up 18.1% in the quarter but down 8.7% for the fiscal year.

Equity securities were distributed by fund as follows:

	6/30/2003
Barclay-Wilshire 5000 Index Fund	84%
International Index Fund	16%
	100%

The Fund realized gains of $42 million on sales of fixed income investments in the quarter and $41 million in the calendar year. Equity securities are recorded at market value; investments in fixed-income securities are usually recorded at amortized cost. Securities below investment grade are carried at the lesser of amortized cost or market value. Bonds with an amortized cost of $74 million were listed at a market value of $59 million due to loss of grade. The current unrealized loss to asset values is $15 million.

The market value of fixed-income investments increases as interest rates decline. Fixed maturities (bonds) are usually held to maturity so that differences between market value and carrying value will not significantly influence management's investment decisions or future investment income or yields.

At June 30, 2003, the investment portfolio consisted of the following (in millions):

Asset Class	Carrying Value		Market Value		Diff
Corporate fixed income securities	3,636	45%	4,135	45%	(499)
Mortgages and mortgage backed securities	1,448	18%	1,585	17%	(137)
Common and preferred stocks (at market)	1,313	16%	1,313	15%	-
U.S. Treasury securities	1,471	18%	1,807	20%	(336)
Debt securities issued by foreign governments	35	1%	37	1%	(2)
Asset backed securities	117	1%	128	1%	(11)
Money market	105	1%	105	1%	-
Total Securities	8,125	100%	9,110	100%	(985)

Commitments and Contingencies

Effective July 1, 1992, the Washington State Legislature required the Fund to participate in an assigned risk pool providing workers compensation coverage under the United States Longshore and Harbor Workers' Act. The Fund is obligated to participate 50% in the operating results of the assigned risk pool. This participation is scheduled to continue; state legislation passed in 1997, which extended the Fund participation indefinitely. No loss was recorded through March 31, 2003.

STATE OF WASHINGTON INDUSTRIAL INSURANCE FUND
SUMMARY of FINANCIAL CONDITION
(000's) omitted
UNAUDITED

Assets	**6/30/2003**	**3/31/2003**	**6/30/2002**
Cash and Investments:			
Bonds, at Amortized Cost	$6,811,345	$6,852,381	$6,777,424
Stocks, at Market Value			
(Cost $1,697,209; $1,720,158; $1,787,244)	$1,313,283	$1,122,183	$1,312,528
Net Unsettled Trades	$68,170	($29,677)	$336
Cash	($26,371)	($2,435)	($15,650)
Total Cash and Investments	$8,166,427	$7,942,452	$8,074,638
Other Assets:			
Premiums Receivable, Net	$305,803	$271,528	$217,280
Interest Receivable	$90,843	$90,703	$98,834
Land, Buildings and Equipment, Net	$57,751	$57,385	$59,254
Other Assets	$20,882	$32	$11,013
Total Other Assets	$475,279	$419,648	$386,381
Total Assets	$8,641,706	$8,362,100	$8,461,019

Liabilities and Contingency Reserve

Liabilities			
Estimated Future Benefits:			
Accident Fund	$3,030,914	$3,223,048	$3,011,406
Medical Aid Fund	$2,609,441	$2,542,611	$2,512,856
Pension Reserve Fund	$1,909,324	$1,821,364	$1,693,227
Total Estimated Future Benefits	$7,549,679	$7,587,023	$7,217,489
Other Liabilities:			
Claims Administration	$435,363	$453,242	$468,887
Retro Rating Adjustments	$110,223	$155,140	$102,793
General Obligation Bonds Payable	$45,507	$45,497	$48,076
Other Accrued Liabilities	$42,314	$32,558	$39,999
Deferred Revenue	$2,022	$2,013	$1,992
Total Other Liabilities	$635,429	$688,450	$661,747
Total Liabilities	$8,185,108	$8,275,473	$7,879,236
Contingency Reserve	$456,598	$86,627	$581,783
Total Liabilities and Contingency Reserve	$8,641,706	$8,362,100	$8,461,019

STATE OF WASHINGTON INDUSTRIAL INSURANCE FUND
SUMMARY of OPERATIONS and CONTINGENCY RESERVE
(in thousands of dollars)
For 3 months and 12 months ending June 30, 2003,
and 12 months ending June 30,2002
UNAUDITED

Revenues	**3 months ended 6/30/2003**	Percent of Net Premium	**YEAR ended 6/30/2003**	Percent of Net Premium	**YEAR ended 6/30/2002**	Percent of Net Premium
Premiums Earned:						
Net Standard Premiums	$294,675	107%	$986,384	111%	$823,087	113%
Retrospective Rating Adjustments	($20,375)	-7%	($101,058)	-11%	($96,571)	-13%
Net Premiums Earned	$274,300	100%	$885,326	100%	$726,516	100%
Net Investment Income	$111,878	41%	$452,552	51%	$490,758	68%
Net Realized Gains (Losses) Fixed Income	$41,759	15%	$40,643	5%	($98,385)	-14%
Net Gains (Losses) Equities	$191,100	70%	$680	0%	($182,872)	-25%
Self Insured Pension Contributions	$15,268	6%	$55,084	6%	$39,368	5%
Other Income (Expense)	$18,018	7%	$18,018	2%	$0	0%
Total Revenues	$652,323	238%	$1,452,303	164%	$975,385	134%
Expenses						
Benefits Incurred:						
Accident Fund	($68,983)	-25%	$500,795	57%	$617,329	85%
Medical Aid Fund	$187,240	68%	$535,792	61%	$467,731	64%
Pension Reserve Fund	$135,943	50%	$401,722	45%	$312,261	43%
Total Benefits Incurred	$254,200	93%	$1,438,309	162%	$1,397,321	192%
Administrative Expenses:						
Claims Administration	$7,177	3%	$62,417	7%	$141,009	19%
Underwriting	$8,908	3%	$30,172	3%	$28,275	4%
General Insurance Expense	$4,064	1%	$15,171	2%	$22,173	3%
Other Administrative Expenses	$18,896	7%	$36,776	4%	$37,702	5%
Total Administrative Expenses	$39,045	14%	$144,536	16%	$229,159	32%
Total Expenses	$293,245	107%	$1,582,845	179%	$1,626,480	224%
Net Income	$359,078	131%	($130,542)	-15%	($651,095)	-90%
Change in Non-Admitted Assets	$10,893		$5,356		$7,091	
Change in Contingency Reserves	$369,971		($125,186)		($644,004)	
Contingency Reserve, beginning of period	$86,627		$581,783		$1,225,787	
Contingency Reserve, end of period	$456,598		$456,598		$581,783	

This information is from Washington State's Accounting and Financial Reporting System.

STATE OF WASHINGTON
INDUSTRIAL INSURANCE FUND
CASH FLOW SUMMARY
(in thousands of dollars)
For the 3 months and 12 months ended June 30, 2003
and
12 months ended June 30, 2002
UNAUDITED

	3 months ended 6/30/2003	Percent of Net Premium	**12 months ended 6/30/2003**	Percent of Net Premium	**12 months ended 6/30/2002**	Percent of Net Premium
Standard Premiums Collected	$260,397	126%	$897,861	106%	$839,594	111%
Self Insured Pension Contributions Collected	$12,135	6%	$45,139	5%	$28,727	4%
Retrospective Rating Adjustments	($65,292)	-32%	($93,628)	-11%	($113,755)	-15%
Net Premiums Collected	$207,240	100%	$849,372	100%	$754,566	100%
Other Income (Expense)	$8,106	4%	$17,313	2%	$12,556	2%
Fund Transfers In (Out)	$2,715	1%	$16,892	2%	$10,138	1%
Cash Flow In	$218,061	105%	$883,577	104%	$777,260	103%
Benefits Paid	$291,544	141%	$1,106,119	130%	$1,018,993	135%
Claims Administration Expense	$25,056	12%	$95,940	11%	$96,074	13%
Premium Administration Expense	$7,078	3%	$26,856	3%	$26,031	3%
General Insurance Expense	$3,695	2%	$13,503	2%	$20,414	3%
Other Administrative Expense	$19,140	9%	$50,895	6%	$44,809	6%
Cash Flow Out	$346,513	167%	$1,293,313	152%	$1,206,321	160%
Operating Cash Flow	($128,452)	-62%	($409,736)	-48%	($429,061)	-57%
Net Investment Income Bonds	$113,345	55%	$471,802	56%	$511,569	68%
Net Investment Income Equities	$6,366	3%	$21,881	3%	$2,142	0%
(Purchases)/Sales	($14,913)	-7%	($94,336)	-11%	($98,840)	-13%
Fixed Asset Activity, Net	($282)	0%	($332)	0%	$0	0%
Net Cash Flow	($23,936)	-12%	($10,721)	-1%	($14,190)	-2%
Beginning Cash	($2,435)		($15,650)		($1,460)	
Ending Cash	($26,371)		($26,371)		($15,650)	

State of Washington
Industrial Insurance Fund

Notes to Financial Information

Note A - Summary of Significant Accounting Policies

The State of Washington prepares a Comprehensive Annual Financial Report (CAFR), which includes all funds and account groups of the State. The CAFR is prepared in accordance with generally accepted accounting principles (GAAP). The financial activities of the Labor and Industries workers' compensation programs are included in the CAFR.

The accompanying financial information uses "statutory" accounting principles, as would be required of a casualty insurance enterprise when reporting its financial condition to insurance regulators.

Under statutory accounting principles, certain assets (principally receivables which are greater than ninety days past due and office furniture and equipment) are charged against the contingency reserve. Under GAAP, such assets would be recorded on the balance sheet as assets, less valuation allowances or accumulated depreciation.

Bonds are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to investment income. Under GAAP, some or all of the fixed income securities would be stated at market value. Gains or losses on disposition are based on net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method. Equity securities are stated at market value. Equity gains (losses) are reflected separately in the income statement.

The Supplemental Pension and Second Injury Funds (See Note C) were not included in these statements because the primary purpose of these statements is to present the financial condition and results of operations of those funds required to maintain actuarial solvency as a basis for premium rates.

Note B - Description of the Industrial Insurance Fund

The State of Washington, through Title 51 RCW, requires employers to secure payment of benefits for job-related injuries and diseases either by paying insurance premiums to the Workers' Compensation Fund or by self-insuring. Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations.

State of Washington
Industrial Insurance Fund

Notes to Financial Information

The statutes provide five benefit funds to make compensation payments to injured employees for various losses. The Accident, Medical Aid, and Pension Reserve Benefit Funds are required to be self-sustaining by insurance premiums. These financial statements report on the financial condition and results of operations of these funds.

The Accident Fund pays compensation directly to injured employees for lost wages during temporary disability, for permanent partial disability awards, and awards pensions to survivors of fatally injured workers and to workers adjudged to be permanently and totally disabled. Claim liabilities are discounted to their present value, as reported in these financial statements, based upon a 4.0% interest rate assumption. Revenues for this fund are provided by employer-paid premiums, calculated on the basis of hours worked. Employers may elect to be retrospectively rated. All retrospective premium adjustments are financed entirely through the Accident Fund. The adjustment calculation considers both Accident Fund and Medical Aid Fund experience and premiums together, however, no retrospective adjustments are made through the Medical Aid Fund.

The Medical Aid Fund pays for the cost of medical and vocational rehabilitation service to injured workers. Employers are allowed to withhold half of the medical aid premium from employees' wages. Medical reserves are discounted to their present value, as reported in these financial statements, based upon a 4.0% interest rate assumption. Revenues for this fund are provided by equal contributions from employers and employees.

The Pension Reserve Fund pays benefits to all permanently disabled pensioners including disabled employees of self-insured employers. These reserves are discounted based upon a 6.5% interest rate assumption. Funding for these pensions is provided by transfers from the Accident Fund and from self-insurers.

The Accident, Medical Aid and Pension Reserve Funds are required to be maintained on an actuarially solvent basis, except that a cash flow basis is authorized for the components of the Pension Reserve fund when self-insured employers guarantee related benefits with a surety bond.

The Agency's actuaries compute benefit and claim administration expense liabilities. Independent consulting actuaries review these liabilities at the end of the fiscal year. The liabilities are estimated future claim and claim administration expense payments for injuries occurring on or before the balance sheet date on a discounted basis. Future premium income is not offset against claim liabilities, as the claims liabilities arise from coverage periods for which premiums have, in general, already been fully earned. The obligation to pay claim and claim administration expense liabilities is not contingent upon any future premium for future coverage periods.

Note C - Other Related Funds

The Second Injury Fund is used to pay pension costs on claims where permanent total disability is at least partially caused by a prior injury. It is funded by amounts received from the Accident and Medical Aid Funds for state fund claims, and by self-insured assessments for self-insured claims. An allowance for future second injury benefit payments is contained within the Accident Fund and Medical Aid Fund claim reserves for State Fund claims. Therefore, this fund does not carry any reserves. This fund's operations are not directly accounted for in these financial statements, but second injury claims, which it services, are accounted for through the Accident and Medical Aid Funds.

The Supplemental Pension Fund provides for supplemental cost-of-living adjustments to injured employees receiving disability payments. However, the enabling statute requires this fund to operate on a current payment basis and is subject to legislative cancellation. No assets are allowed to accumulate for the future servicing of current claims.

Cost-of-living increases are based on the increase in the state average wage during the preceding calendar year and are granted in July. This fund is financed through assessments to self-insurers and State employers; half of the assessment may be deducted from employees' wages. Income, expense, assets, or future claim liabilities related to Supplemental Pension or Second Injury Funds are not included in the attached financial statements.

The Second Injury Fund and the Supplemental Pension Fund are included in the CAFR. Because these funds are not required to maintain actuarial solvency, as the Accident, Medical Aid, and Pension Funds do, they are not included in this financial information.

Note D - Premiums Receivable, Net

All employers in the State of Washington subject to Title 51 of RCW are required to be covered by the Industrial Insurance Fund and pay policy premiums for workers' compensation insurance, except for certain qualifying employers electing to self-insure. Premiums are normally based on individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience. In addition to its regular premium plans, the Fund offers a retrospective premium rating plan under which premiums are adjusted annually for up to four years following the plan year based on employers' loss experience. Adjustments to the original premiums are paid to or collected from the associations and employers approximately ten months after the end of each plan year.

Employer premiums are due 30 days following the calendar quarter covered. An allowance for uncollectible premiums is established when the account becomes delinquent.

Note E - Reinsurance

The Agency maintains an agreement with a reinsurance broker to purchase reinsurance at reasonable rates. The current rates are believed to be aggressively in excess of reasonable. The Agency therefore carries no catastrophic reinsurance cover, but remains in contact with the broker and will purchase reinsurance when it becomes available at appropriate rates.

Note F - Estimated Future Benefits

Reserves for unpaid benefits and claims administration expenses in the Accident Fund and Medical Aid Fund are provided based primarily on ratios of paid to date losses for older accident periods. For more recent accident periods, a selection of several common actuarial techniques is used. These estimates are continually under review and, as changes to the liabilities become necessary, such adjustments are reflected in income currently. The estimates are calculated and presented net of all recoveries. Recoveries include overpayments and successful subrogation against third parties. Recoveries may be in the form of cash or deduction against continuing benefits.

The liability for benefits for the Pension Reserve Fund is determined from individual claims transferred to this fund. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided.

STATEMENT OF ACTUARIAL OPINION - DEPARTMENT OF LABOR & INDUSTRIES AS OF JUNE 30, 2003

Identification

I, Guy A. Avagliano, am associated with Milliman USA, Inc. I am a member of the American Academy of Actuaries and meet its qualification standards for statements of actuarial opinion. I am also a Fellow of the Casualty Actuarial Society. The loss and loss adjustment expense reserves are the responsibility of the Department's management; my responsibility is to express an opinion of those reserves based on my review.

Scope

I have performed an actuarial review of the reserves for loss and loss adjustment expense as of June 30, 2003 in the Accident Fund ($3,210,868,000), Medical Aid Fund ($2,864,850,000), and Pension Reserve Fund ($1,909,324,000) for the Department. These reserves are contained in the Industrial Insurance Balance Sheet as of June 30, 2003.

My examination of the loss and loss adjustment expense reserves was based upon the review of the data and related information, methodology, assumptions, and calculations utilized by the Department. In this regard, I relied on the Department as to the accuracy and completeness of the data. In performing this evaluation I evaluated the data used directly in my analysis for reasonableness and consistency. My evaluation did not reveal any data points materially affecting my analysis that fell outside of the range of reasonable possibilities. In performing this evaluation, I have assumed that the Department (a) used its best efforts to supply accurate and complete data and (b) did not knowingly provide inaccurate data. In other respects, my examination included the use of such actuarial assumptions and methods and such tests of calculations as I considered necessary.

My review was limited to the items listed above and did not include an analysis of any income statement items or other balance sheet items. My opinion on the reserves is based upon the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet cash flow requirements.

I evaluated the loss and loss adjustment expense reserves on a discounted basis with regard to the time value of money. The average interest rate used to discount was 4.6%, which I consider reasonable. I evaluated the loss and loss adjustment expense reserves, net in regards to salvage and subrogation, and gross of reinsurance.

Opinion

In my opinion, these reserves are consistent with reserves computed in accordance with Standards of Practice issued by the Actuarial Standards Board (including the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves) and make a reasonable provision for all the unpaid loss and loss adjustment expense obligations of the Department under the terms of its policies and agreements.

Comments

The Department writes a coverage whose risk factors expose the Department's reserves to significant variability. I have identified the major risk factors that could have a material impact as rising medical costs and any future court decisions that could have a retrospective impact on liabilities. The potential impact of these risk factors is described in more detail in the following paragraph and in the report supporting this opinion. The absence of other risk factors from this listing does not imply that additional risk factors will not be identified in the future as having been a significant influence on the Department's reserves.

The risk factor of rising medical costs is evident by the escalation of recent national trend levels and continuation at this level would have a material impact on the reserves. Future court decisions are also a risk factor that could have a material impact, with a recent example being the impact the Cockle decision had on reserves.

I believe the risk factors above, coupled with the variability that is inherent in any reserve estimate, could result in material adverse deviation from the carried reserve. In making this determination, I have considered a material adverse deviation to be one in which the actual reserves exceed the amounts above by an amount greater than 10% of the reserves. Other measures of materiality might be used for reserves that are being evaluated in a different context.

In evaluating whether the reserves make a reasonable provision for unpaid losses and loss expenses, it is necessary to project future loss and loss adjustment expense payments. These estimates incorporate actuarial assumptions as to future long-term contingencies based upon the available data. It is certain that actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further the projections make no provision for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the Department's historical database or which are not yet quantifiable.

This statement of opinion is solely for the use of, and only to be relied upon by, the Department and the State of Washington.

Guy A. Avagliano
Fellow, Casualty Actuarial Society
Member, American Academy of Actuaries
November 6, 2003

MILLIMAN USA